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NSC FOR PAUL BROWN AND JONATHAN SHRIER  
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SUBJECT: PROGRESS MADE DURING FIVE PARTY ENERGY MINISTERIAL

REF: TOKYO 1505

11. Summary. Representatives from the U.S., Japan, China, India, Korea and the International Energy Agency (IEA) gathered for the five-party energy ministerial in Aomori, Japan June 7. Participants agreed recent volatility in global energy markets and skyrocketing oil prices are largely due to the lack of investment in energy infrastructure, although the Chinese representative argued that financial market speculation was a major factor. Participants cited the need for open and transparent legal and regulatory environments to encourage investment. They also called for greater energy efficiency, diversity of energy sources, better emergency preparedness and for the elimination of subsidized energy prices. The Chinese representative noted ending subsidies would unduly impact its rural communities while the Indian representative stated his country could not completely lift price controls given "irrational" oil prices. End summary.

12. Representatives from the U.S., Japan, China, India, Korea and the IEA gathered in Aomori, Japan June 7 for the second five-party energy ministers meeting, preceding the G8 energy ministerial June 8. Discussions focused on oil markets, and the themes of global energy security challenges, emergency preparedness, the investment climate and energy efficiency and diversification.

#### Five Steps to Energy Security

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13. During the session on global energy security challenges, IEA Executive Director Nobuo Tanaka posited five steps to ensure energy security in the future. First, significantly more investment is needed to address under-capacity across the oil value chain. Second, governments must encourage more efficient consumption. Third, more diversity in terms of alternate energies and other sources is necessary to reduce

reliance on oil. Fourth, more transparency in reporting of key data such as strategic reserve holdings and other indices would provide accurate information to oil markets to help reduce volatility. Finally, Tanaka advocated emergency preparedness to avoid supply chain interruptions in the event of natural disasters or geopolitical upheavals.

#### Subsidies

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¶4. Both Tanaka and Energy Secretary Bodman urged elimination of subsidies that keep oil prices artificially low and prevented a demand response to high international prices. Chinese National Development and Reform Commission (NDRC) Vice Chairman Zhang Guobao argued forcefully that financial market speculation was a major factor in the jump in the oil price, and observed that eliminating subsidies would unduly harm China's citizens, particularly in rural areas. Indian Ambassador to Japan H.K. Singh noted recent hikes in India for fuel and heating oil to encourage consumers to be more energy conscious while indicating that complete removal of price controls were not possible given the "irrational" level of prices.

#### Strategic Reserves Not a Weapon Against High Prices

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¶5. China's Zhang led the discussion on emergency preparedness, saying China's eleventh five year plan calls for the development of a strategic oil reserve. He said China is not trying to hide information about its stock build-up but is concerned more transparency regarding oil

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purchases may drive markets even higher. Singh stated, while the Indian government had approved building a reserve of 15 million metric tons, storage facilities would not be ready for another three years. Both China and India noted their interest in further cooperation with the IEA on emergency preparedness and other issues. In response to Korean Knowledge Economy Minister Lee Youn Ho's suggestion that IEA members could release some stocks should oil prices reach a "certain level," Secretary Bodman cautioned using strategic reserves as a weapon against high prices would be unsustainable.

#### More Investment in Production Capacity Needed

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¶6. During the session on investment climate, Secretary Bodman stated high oil prices are primarily due to the lack of investment in the energy supply chain. Countries need to have open and transparent legal and regulatory environments to encourage investment in the sector, he said. Bodman called for countries to fulfill their Joint Oil Development Initiative (JODI) commitments and noted the importance of the Extractive Industries Transparency Initiative (EITI) to a good investment climate, urging candidate countries to complete implementation of the EITI criteria. (Korea echoed Bodman's EITI comments.) Japan's Minister of Economy, Trade and Environment Akira Amari decried the rise of resource nationalism and stated the private sector's short-term focus on profits together with the lack of attractive short-term projects had dampened investment. China's Zhang said his country's investment in international energy projects should not be seen as a threat but rather as contributing to stabilizing global oil markets.

#### Energy Efficiency and Diversification

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¶7. ROK's Lee led the discussion on energy efficiency and diversification, describing his country's efforts to increase nuclear power, liquefied natural gas (LNG) and renewable energy sources, as well as Korea's extensive energy efficiency efforts. Meeting participants accepted the Minister's offer for the ROK to host the next Five-Party Ministerial.

¶8. Secretary Bodman stressed the need to let markets set

energy prices and commended India's recent actions to reduce energy subsidies. Vice Chairman Zhang noted that China's energy intensity is related to its stage of development, but as a result, there is great potential for improvement by phasing out older, less efficient industrial plants for example. Amb. Singh remarked on India's use of public policy to promote efficiency and create markets for renewable energy and alternative fuels.

Comment

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¶9. The second Five-Party Energy Ministerial marked a major advance over the first such gathering in Beijing in December ¶2006. The group agreed to a strong statement on data transparency, committed to an eventual phase-out of subsidies, welcomed countries' efforts to implement EITI, and endorsed the St. Petersburg Energy Security Principles agreed by the G8 at its 2006 Summit. The five parties welcomed the forthcoming discussion on oil markets at the G8 Finance Ministers Meeting on June 13-14.

¶10. The Secretary's party has cleared this cable.  
SCHIEFFER